RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Sept. 14, 1994 **LETTER 1156**

THE MARKET: When the picture is a bit confusing (as it is now), I always turn to the method of analysis which I have found most dependable. Of course, I'm talking about the Dow Theory method of "reading" the Averages.

In recent Letters I have emphasized the following: (1) The critical downside levels for the Averages are the April lows. Those lows are **3593.35** for the D-J Industrials and **1546.02** for the D-J Transports. If the market turns down and both of those lows are violated, the bear market will be reconfirmed. At that point, even those who disagree with my bear market designation would be forced to throw in the towel.

(2) As you can see (referring to the page 1 chart), the Dow has bettered its June 14 peak of 3814.83. But according to Dow Theory, a penetration of one Average, not confirmed by the other, is useless for forecasting purposes and more often than not -- deceptive. It's been almost three months since the Transports recorded their **1661.45** high of June 16. And so far the Transports have refused to better that June 16 high.

Thus, from a Dow Theory standpoint, the most important current consideration is that although the Dow has bettered its June 14 high, the Transports have stubbornly refused to confirm.

Is there a rationale for the confirmation principle? There is indeed. The Industrial Average represents the manufacturing capabilities of the nation. The Transportation Average represents the sales (and shipping) capabilities of the nation. If the economy is to prosper then goods that are manufactured had better be shipped out. By the same token, if goods are sold then the factories better be able to fill the orders. Thus, it is crucial that each Average confirm the indications of the other.

The question: why has the Transportation Average been unable to climb above a peak that it recorded just three months ago? We have to ask -- in refusing to confirm the action of the Industrials, is the carrier Average telling us that sales in the US are fated to drop off? Are corporations making goods that are fated simply to pile up in inventories? Dream up your own scenario, but the operative fact is that as of this writing, the Transports have refused to confirm the action of the Industrials. Under Dow Theory, that's a warning sign.

In the meantime, my Primary Trend Index (see page 2 chart) has pushed substantially above its own 89-day moving average, then more recently, it turned down again. That's hopeful action, but it doesn't change the direction of the primary trend of the market. I give first priority to my market interpretation under Dow Theory. I view the PTI action since June as offering short-term encouragement to traders, not as a harbinger of a return of the bull market.

The advance-decline ratio rallied to its June peak, then declined. This action, too, might gladden the hearts of stockholders, but remember (and this is important) the A-D ratio is still far below its high recorded on February 2.

FURTHER COMMENTS: Back in the mid-1940s when I first began dealing with the stock market, investors were both cautious and conservative. And they had a right to be. They had been scarred by the crash of '29, the unbelievably vicious bear market of 1929-32, and the Great Depression that followed.

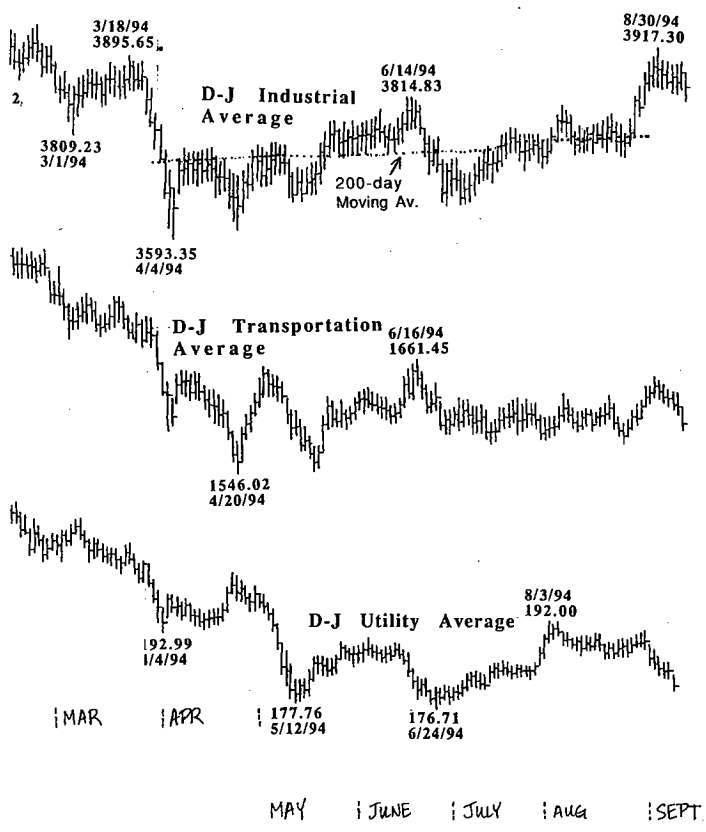
Sept. 2 DJIA 3885.58; PTI 4040; A-D Ratio -5.27
Sept. 9 DJIA 3874.81; PTI 4036; A-D Ratio -5.56
Dow Yield: 2.71%; Dow Price/Earnings: 20.5
Dow 200-day MA: 3778; Dow 30-day MA: 3823
Dow Times Book Value: 3.46; PTI 89-day MA: 4021
Percentage of Undervalued Blue-chips: 10%
Dow Low Risk Buy Index: +28; Gold-PTI: 1019
Gold 40-week MA: 384

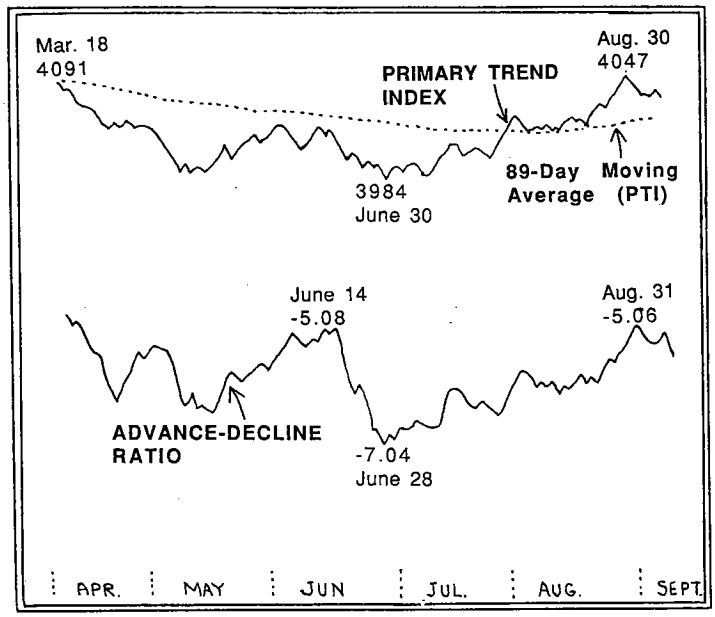
Two decades later investors were still traumatized by the events of the 1930s. During the Depression my father was willing to own only two stocks -- American Telephone and Woolworth. The reason -- these two companies had the distinction of never cutting their dividends despite year after year of hard times (AT&T was famous for its ultra-dependable, "Depression-proof" $9 dividend).

During the 1930s and '40s investors (believe it or not) used this "formula" -- a stock was considered a reasonable value if it sold at ten times earnings and provided a dividend of 6% or more. However, if you wanted real safety, you bought triple-A rated bonds or US government bonds. All during the 1930s to the early '50s stocks yielded more than bonds (since stocks were still considered highly risky).

During most of the history of the stock market dividends and yields played an important part in the minds of investors. But during the late-'80s and early '90s yields were forgotten, and momentum and growth became the favored criteria.

Yet, yields (or the return on investment) still constitute the single best indicator as to the relative valuation of the stock market at any given time. At the turn of the century Charles Dow noted that when the average yield on stocks drops to 3% or less, stocks are





Notes on the chart above: The PTI rallied above its 89-day moving average, but since August 30 it has been sliding off. The advance-decline ratio appears to have formed a "double top" in the -5.05 to -5.08 area and continues to appear weak (it's still far below its Februry 2 peak of -1.17).

overpriced and subject to a bear market. Dow's early observation proved valid during most of the past hundred years.

Yet today we see the Dow selling at one of its lowest yields in stock market history. What's changed? Has anything changed? How is it that the Dow and the S&P Composite can sell at yields well below 3% for months on end without setting off a collapse? (Currently the Dow dividend yields a minuscule 2.64%.)

The answer is that investors' sentiment has indeed changed. Sentiment has turned wildly optimistic or maybe I should say -- stubbornly complacent. Behind the sentiment change is the fact that the major stock indices and averages have been climbing ever since 1974. When there were sharp declines or even crashes, such as in 1987 and 1990, in a matter of months the stock averages recovered to new highs. Furthermore (and this is amazing), in the last 12 years we have never had a year when the low of one year had broken below the low of the preceding year. So here in 1994 the prevailing sentiment is, "Never sell good stocks; never sell a well-managed mutual fund. And if stocks decline temporarily, average down, but keep buying. Accumulating good common stocks is the royal road to riches."

Adding to this psychology, we have just experienced an unprecedented three years (1991, 1992, 1993) of the lowest volatility in stock market history. During these three years stocks floated gently upwards, and it was only in 1994 that many individual stocks (but not the major averages) were battered. The most recent reports indicate that the public is again pouring money into mutual funds while at the same time new funds are being formed almost daily.

As I see it we are now at the very high end of the sentiment cycle. Wall Street has made billions, the public is enthralled with the stock market, money continues to pour into stocks and funds and the analysts tell us that the path of the stock market is onward and upwards.

This psychology is the exact opposite of what it is like at the bottom of the cycle. I remember back in late-1974, at the tail end of the long, ghastly bear market, I was becoming bullish. Stocks had been brutalized, they had been battered, they were on the bargain table. People who were out of the stock market were boasting of the fact to their neighbors and thanking their lucky stars that they were out.

In late-1974 I began accumulating stocks, and one stock that I wanted was General Cinema (GCN). The stock was selling on the NYSE for 10. I called my broker and told him to put in a "good 'til canceled" order for 1000 GCN at 5. He reminded me that the quote was 10, and I answered that I knew it, but "put the bid in at 5 anyway." A few days later there was a panic, and someone must have told his broker to sell GCN "at the market." My bid was evidently the only bid on the books. I got 1000 shares of GCN at 5. My broker was amazed. But that's what it was like at the bottom of the cycle when nobody wants stocks, event though stocks are fabulous values.

William Hamilton, the great Dow Theorist and editor of the *Wall Street Journal*, wrote, *"Cheap stocks are never attractive. This is no paradox but a matter of record. If cheap stocks were attractive there would be an active market today, with an interested and even excited public."* This was written in 1921 at the very beginning of the historic 1921-1929 bull market.

Yes, there were great values in 1921, as there were in 1974, but the public wasn't interested in "cheap stocks." Today, as at the 1929 top, the public is enamored with expensive stocks. But as night follows day, the expensive stocks of today will be the cheap stocks of the next bear market bottom.

What will cause 1994's expensive stocks to become cheap? The biggest change will come in the price-to-earnings ratios and the price-to-dividend ratios. In other words, it is the ratios that will decline, which is another way of saying that investors will be willing to pay maybe ten times earnings instead of today's 20 times earnings. And investors will be willing to pay only 15 to 17 times dividends instead of today's 28 times dividends.

Next question -- what could possibly cause investors' sentiment to shift so radically? Answer -- I honestly don't know. I can guess, but your guess may be better than mine. All right, a few possibilities: the dollar could collapse; a severe recession might set in; a war could start; a series of natural catastrophes could occur; taxes could be raised to intolerable levels; foreign (Asian) competition could squeeze US industries; US debt could reach unsustainable levels. Or it could be a combination of a few of these or very possibly something that you or I have not thought of yet.

However, one way or another the down cycle will assert itself, and it will be called a bear market and recession or a depression. It isn't a question of whether the cycle will turn down -- it's basically a question of when. Or (since none of the stock averages and indices have hit new highs on this latest recovery), shouldn't we believe that the cycle has already turned down?

INVESTMENT POSITION: The bear remains in the box. Which means that if you insist on "accumulating" common stocks here, you'll probably end up getting knocked out of the box yourself.

I note that a number of Wall Street analysts are talking about "a minor dip from here, then a big rally to a final top maybe arriving at the end of the year or during the first quarter." Sounds good, but with stocks as over-priced as they now are, the risk reward for playing a rally hardly compensates for the danger of getting caught in a major bear market decline. In other words, with the Dow yielding less than 2.70%, why fool around? It just isn't worth it.

Gold again looks hopeful. We've been fooled so many times with gold that you have to wonder whether the metal will ever get over 400. I think it will, and my Gold-PTI is looking better than it has for months, but, but, but.

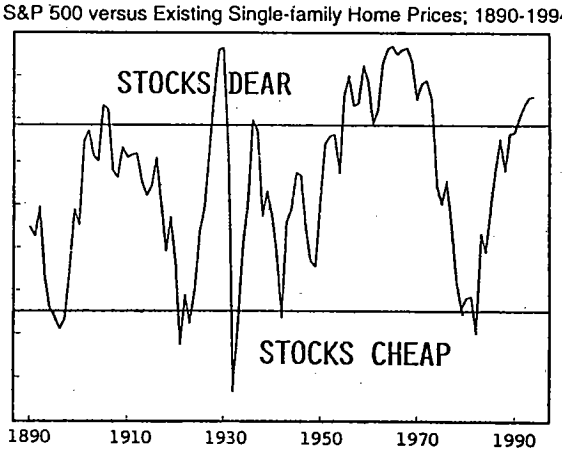
The gold shares have been acting pretty well over the past few weeks (see gold section on page 6). And you can be sure that Alan Greenspan is watching gold and the gold shares as closely as we are (more on page 3).

Speculation: I bought the December 400 gold call options (paid 4.10), and I'll hold 'em for a while. But if gold doesn't move substantially above 400 within two or three weeks, I'll take a small profit and kiss them good-bye. Remember, options erode over time. For the average subscriber, stay with the bullion coins and the gold stocks. Options are for old-timers who have gone through the mill.

STOCKS, HOMES: Paul Macrae Montgomery of *Legg Mason Wood Walker* does some very interesting and original work. I just received one of Paul's reports, and in it he offers this chart of the S&P 500 vs. single family homes, a chart spanning the years 1890 to 1994. The graph doesn't tell you anything about the absolute level of prices (because it's a ratio), but it does tell you when homes are expensive compared with stocks or vice versa.

Right now the chart is telling you that stocks are expensive compared with single-family homes. In other words, if you had to buy stocks or an equal value in a home, you're better off buying a home. Of course in a broad collapse the price of both stocks and houses could go down, but home prices would probably hold up better than stocks because homes are the better value based on over a hundred years of comparisons.

S&P 500 versus Existing Single-family Home Prices; 1890-1994



This chart is particularly interesting to me because I believe there is a trend just now starting, a trend to tangible items and away from financial items. A home is tangible whereas stocks are financial items. Thus all things considered this chart is suggesting that homes and commodities and jewels and collectibles are preferable to stocks and bonds at this juncture. In a second more detailed chart (not shown), Paul indicates that the stock/homes ratio has now turned down in favor of homes rather than stocks. Russell prediction: Both houses and stocks will be heading down, but stocks will do considerably worse than homes.

NOTES & QUOTES: Lamar Alexander (former Tennessee governor who will be running for the presidency on the Republican ticket) said the following on returning from a recent trip around the US: *"I've never seen the depth and breadth of disillusionment in government that I've seen on this trip."* Russell comment: You've got that right, Governor. An increasingly large segment of the US population is "mad as hell" at government, and they're vowing not to take it anymore. These people are convinced America has become the land of high-priced entitlements, endless varieties of "rights" and demands, government intrusions in every area of life, high and higher taxes, widespread government corruption and unlawful evasions of the US Constitution.

In his latest report, Harry Browne, who's been fed up with government for years, announces that he is running for President of the United States on the Libertarian Party ticket. Call Harry at (703) 385-5377. Wait, there's more -- movie producer Aaron Russo ("The Rose," "Trading Places") is actually starting a new political party, a party that aims to bring back individual rights and real freedom (including freedom from government) as originally put forth by the US Constitution. Russo has come up with the very intelligent idea of naming the new party, "The Constitution Party." Their logo -- a coiled snake with the warning, "Don't Tread On Me." Aaron tells me that he's absolutely amazed at the widespread interest and enthusiasm being generated by the new party. Interested? Call the Constitution Party at (800) 932-9888.

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For the average American, one way of protesting what's happening is to vote out what's in -- the incumbents. Charles Cook (*The Cook Political Report*) says, "The question is whether Democrats are going to take a hit, take a big hit or take *the big hit.*" The BIG HIT would be losing control of the House. Political analysts predict Republicans could pick up 20, 25 or even 30 seats in the House. Just 20 wins could stymie President Clinton's legislative plans. And 40 would give the Republicans a majority, the first since the Eisenhower days. Republican strategists believe if the elections were held today, they would pick up 40 new seats. Russell opinion: the stock market and the economy over the next two months could decide the story. My guess -- a bear market decline during September-October would give the Republicans a House majority.

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It may not be the best business in the world, but it's darn close to it. I'm talking about owning a mutual fund. *Smart Money* magazine (Sept.) features an article entitled, "Nice Work If You Can Get it." The piece is subtitled, "You think you've done well in mutual funds for the past few years? It's chump change compared with what these guys have made." A few examples: Ed Johnson III, the big guy at Fidelity; he's worth $4.5 billion (that's billion). Mike Shanahan, Jon Lovelace and Dave Fisher; they're the head honchos at Capital Group and their net worth is $850 million. The two Stowers boys of Twentieth Century; they're worth $650 million. The two Johnson guys and Martin Wiskemann of Franklin Resources; they're worth just $1.4 billion. Mike Price of Heine Securities; he's worth at least $250 million. Rich Strong of Strong/Corneliuson Capital is worth at least $230 million. The talkative Mario Gabelli of Gabelli Funds is worth $175 million. Steve Lieber of Evergreen Asset is worth $165 million. My old friend, Jim Benham of Benham Management is worth a tidy $80 million. The list goes on and on but you get the idea. Don't buy shares in a mutual fund, start your own fund (and everybody, it seems, is doing it) -- that's where the real money is.

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Talk about gravy trains, Congress could be seeing the end of one of its own gravy trains. The National Taxpayers Union and US Term Limits note that members of Congress have voted themselves retirement years "entitlements" that are more than twice as large as any received by executives of the Fortune 500. The average lifetime pension for members of Congress is now more than $1.5 million. Is it any wonder that Congress is the object of anger and scorn by a majority of the American public?

* *

When the bear arrives, Wall Street is the first to know it. Are these a few of the early signs?

Big Board's Member Firms Had Losses Totaling $622 Million in 2nd Quarter

By Anita Raghavan
Staff Reporter of The Wall Street Journal

NEW YORK – The New York Stock Exchange said member firms that do business with the public posted a pretax loss of $622 million in the second quarter – the first quarterly loss since the fourth quarter of 1990.

That's a sharp downdraft from the year-earlier quarter when member firms earned $2.38 billion before taxes on revenue of $17.95 billion.

Wall Street Bonuses Likely To Tumble

By Anita Raghavan
Staff Reporter of The Wall Street Journal

NEW YORK – Forget those fat bo- Merrill
nuses.

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Ho Hum, more Hillary. Now it turns out that Hillary's health-care task force was twice as big as reported and cost millions of dollar more than advertised. Clinton told Congress that the group's activities cost taxpayers $100,000. Turns out the final bill comes out to $4 million and maybe up to $20 million. The White House said originally that about 500 people participated in the secret health sessions. Turns out that 1,000 to 1,200 people were involved.

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Life isn't always a bowl of cherries. Take Chairman Lloyd Cotsen of Neutrogena. Johnson & Johnson is buying his company, and Cotsen's 38% stake is worth $348 million. Cotsen started at Neutrogena in 1957 when he married the boss' daughter. In 1979 his wife and teenage son were found murdered in Beverly Hills. Then Cotsen's second wife filed suit in 1992, charging him with failing to deliver $1.5 million in Neutrogena stock that he had promised. Cotsen denied the charge. As I said, life isn't always easy.

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All may be fine when China takes over Hong Kong in three years. But two weeks ago, for the first time in ten years, a block of public land was put up at auction in Hong Kong -- and there wasn't a single bidder. To avoid embarrassment, the Chinese government bought the land.

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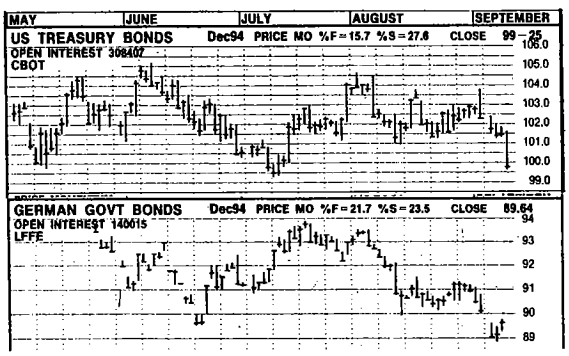
One of the disaster areas of the year has been international bonds. According to *Morningstar,* world bond funds showed a total return of minus 6.29% (year to July 22), while US government bond funds provided a minus 4.49% total return. With almost every nation in the world opting for more money and more debt, the price of money has risen steadily. The price, of course, equals interest rates. In the process, holders of international bonds have sustained large losses. This chart (courtesy of *Investor's Business Daily*) shows you the story in German bonds. However, for US holders of German bonds there's been some relief in that the mark has appreciated against the dollar (see chart).



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Health: More than half the premature deaths in the Western world are thrombosis related, meaning that they are related to blood clots. Thrombosis is caused when tissue factors combine with another protein in the blood. This starts a biochemical reaction which ends in the formation of a solid clot, which may block a blood vessel and cause damage. Now a team from Oxford and Edinburgh Universities has identified the protein that sets off the clot. The discovery, hopefully, will allow for the development of drugs that will block thrombosis by inhibiting the interaction of the protein and tissues that cause the clots. And then, maybe -- no heart attacks or cerebral hemorrhages.

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Life in Russia -- Last week the ruble fell to a record low against the dollar. Despite the awful slide, Russia's central bank announced that it was cutting its three-month refinancing rate to 130% from 150%, the seventh cut of this year.

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Variety headline when Katzenburg left the Disney Company: **"Katz Leaves the Mouse."**

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You knew it had to happen: Turner Home Entertainment and CNN will produce a new CD-ROM -- *"The People vs. O. J. Simpson. An interactive companion to the O. J. Simpson trial."*

* *

Talk about high-tech, giant DeBeers has a converted oil exploration boat searching the sea bottom 17 miles off Namibia for diamonds. The boat literally vacuums up diamonds off the ocean bottom. Sucking up tons of material a minute, the diamonds are sorted from the bottom material and then for security reasons are put in cans and sealed (like peaches or pineapple chunks). To locate the field, DeBeers searched an area the size of Holland. The diamonds are 60 million years old, washed down the Orange River by thunderous downpours from the Transvaal. For your information, diamonds are not rare, only large gem-quality stones are rare. The real rare precious stones of the quartet (diamonds, rubies, sapphires, emeralds) are rubies. A miner can search for a month before finding a single ruby. The finest rubies come from Burma, where a military dictatorship rules and where it is the death penalty for smuggling out rubies.

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You may think the global population explosion is fine and dandy, but I don't. As a matter of interest, India's population is now increasing at more than one million a month. During the very early part of the next century India's population will surpass China's, and India has no serious plan to halt the population time bomb (40% of the Indian population lives in poverty).

The fact is that the world population explosion is playing havoc with nature, including the vanishing rain forests and the increasingly polluted oceans. Certain species of fish are being depleted and nations are fighting over fishing rights. You like deep sea fishing? Then you won't like these headlines which I collected over a few days. By the way, when I was a kid fish was considered a cheap dish, reserved mostly for those who couldn't afford beef and for Catholics on Friday. Today fish is expensive, often more expensive than beef.

Conflicts have erupted worldwide. The oceans are 'in crisis', the UN has been told

Fleets fight in over-fished waters

Falklands rivalry tests quick tempers

Diplomats in Buenos Aires must learn the mating and migratory habits of squid, writes **John Barham**

Spanish fleet goes to war over drift-nets

By David Gardner on the Spanish Basque coast

A thin curtain of drizzle, mist and diesel fumes hung over the

Asian fleets roam in search of bluefin tuna

Japanese run gauntlet of Russian bullets

By Gordon Cramb in Tokyo

When Russian coastguards fired on a Japanese fishing boat this month, wounding a

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According to government figures, the salaries between the educated and the partially educated are widening. In 1992 a college educated person earned 83% more than a high school educated person. The old middle class has now split into three groups. The underclass, found mostly in the big cities. The overclass, positioned to ride the changes now occurring. And the largest group, the in-betweens, which has been called "the anxious class." These are the ones who hold jobs but are worried about their jobs and who are even more worried about their children's futures.

Russell comment: I can tell by the many letters that arrive here that Americans in general are very concerned about what's happening to the nation. Crime is rampant, people are seriously worried about their safety, taxes are a problem for almost everyone, government regulations and red tape are driving businessmen up the wall and the quality of life continues to decline. I think the biggest complaint, however, has to do with big government. The American people are increasingly disgusted with big government. They're fed up with big government's interference in almost every segment of their lives. I'm sure Congress sensed some of this when they backed off from the Clinton health plan (which was basically a government takeover of America's health industry). The more the American people thought about a government takeover of health, the less they liked the idea.

* *

Speaking of health, the latest concept is that if you want to lose weight, cut down on the carbohydrates (yes, pasta, breads, rice, potatoes, etc.) and increase your intake of proteins (meats, chicken, fish) plus add lots of leafy vegetables and easy on the fruit. The carbs turn into sugar, which is used as fuel. To lose weight you've

got to burn up fat and if you're just burning up sugar you're not going to lose weight. Eating pure protein burns up fats but it also burns up muscle mass in a process called ketosis (which brings on fatigue and may cause kidney strain). Eating mostly carbs means building up a lot of sugar (carbs turn into sugar) and probably gaining weight. Ideal is some protein, some carbs and some polyunsaturated oils. But to cut down weight, cut down on carbohydrates. Unless you're an athlete, a heavy carb diet will make you a heavier person. Interesting aside -- despite all the emphasis on a low-fat diet, Americans continue to put on weight. Reason -- a diet too heavy in carbs even though Americans have cut down on fats.

* *

I don't get these very often, but here's a letter I received last week: "Richard Russell, I've written to you regarding this subject at least once previously. Apparently, you judged it to be unimportant. You'd best pay attention to and respond to this one, or you've lost my subscription -- I'll insist on a refund of my recent renewal. Almost every Letter includes a dig at the Clinton Administration and how 'hypocritical' they are. A market letter such as yours is not the place to throw inaccurate and unfair criticism . . . If you cannot take your Republican blinders off and stay with market discussions, count me out. I do appreciate your expertise on market analysis, and subscribe for that reason. So if you can reassure me that you'll eliminate your Republicanism, I'll stay with you." (From Spokane, name withheld.)

My answer was as follows: "Dear ---, One of the pleasures of my business is that I have 7,000 subscribers, which means that no one subscriber can bully me or threaten me or 'tell me' what to, or what not to, write. I'm also 70, which means to me that I have a right to say what I want (I've been around long enough). As I see it, Clinton and his wife represent two of the biggest hypocrites ever to reside in the White House. On top of that, they are constantly pushing more entitlements and bigger government, both of which, I believe, are absolute poison for America.

My suggestion -- if you don't like my opinions on the Clintons or on politics in general, just read the stock market parts of the Letter. But please, no more bullying or telling me what to write. I've been writing these Letters since 1958, and if I only wrote about the market I'd have been bored to death years ago and would probably now be doing something else (I've often thought of writing movie scripts. I have a well-known producer friend who's asked me year-after-year to write scripts for him, but no, I'd rather write scripts for my subscribers.) By the way, I'm not a Dem or a Repub, I believe in the Constitution, a stance which seems to have escaped most of today's pols. I appreciate your 'suggestions,' but as I said, I'm too old to be 'told' what to write. Sincerely, Dick Russell."

* *

Even the hedge funds have had their troubles. *Financial World* (Sept. 13) notes, "So far this year, investors have pulled roughly $900 million from poorly performing hedge funds and are threatening to withdraw at least that much by the end of the year if the lousy performance doesn't reverse itself." They add that a number of hedge funds have closed shop this year, many of them with large losses.

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I well remember the bull market top of early 1966, and then the many mini-bull and mini-bear trends that followed. But the post-'66 period never produced a full-fledged bull market -- only the hope of one. By the time the long, deceptive bear market period ended in late-December, investors were pulverized. Holding on through the whole cycle -- 1966 to 1974 -- produced losses of 50% to 90%, while many stockholders were wiped out completely.

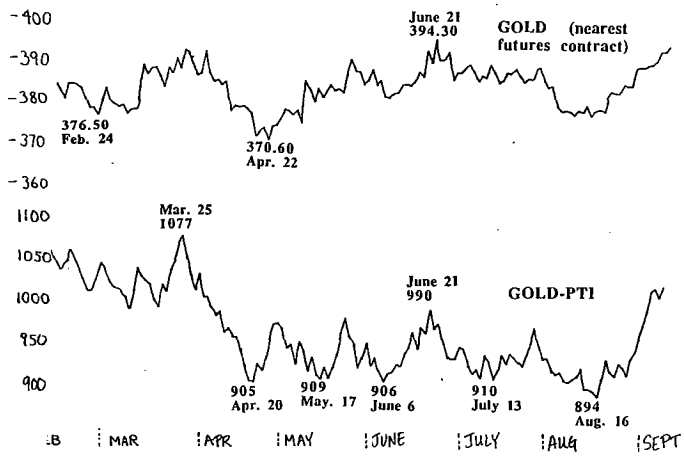
And frankly, I don't like the way this bear market is starting out. I particularly don't like the way the public is remaining steadfastly bullish. Bullish? That's right, I don't care what people are saying, I care about what they're doing. And what they're doing is buying mutual funds, endlessly.

NEXT MAILING: Sept. 28, 1994

DOLLAR, GOLD: Like everything else in the world of finance, the dollar is subject to the laws of supply and demand. In his latest report, Dr. Kurt Richebacher notes that "last year, for the first time in history, the US recorded both a huge current-account deficit ($103 billion) and a long-term capital-account deficit." This meant that the US needed capital inflows of over $338 billion, just to cover these massive deficits. Richebacher adds, "What ails the dollar is obvious, an appalling global oversupply (of dollars) stemming from the deficits of both its current and long-term capital accounts."

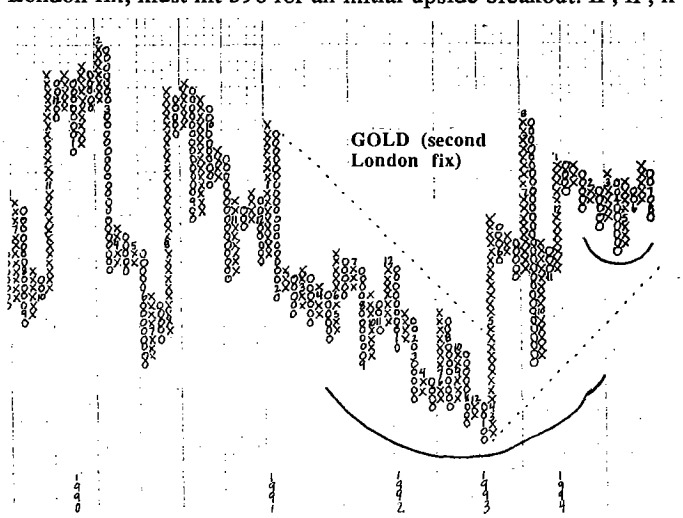
Last week all the major (foreign) currencies pushed toward their '94 highs, this as the dollar flirted with its lowest level since 1992. In the face of the weak dollar, bonds tumbled. The great fear among sophisticated and knowledgeable investors is that we could get into a situation where US stocks, bonds and the dollar all head south together.

The picture was not lost on gold. No sooner had I sent the last Letter to press than my Gold-PTI started up. Last week (see accompanying chart) the G-PTI surged above four preceding peaks -- it also rallied up through a nine-month declining trendline. Since September 2 the rise in the G-PTI has been persistent. As of September 7, the G-PTI had advanced on seven consecutive days; it had not done that since October of 1993.



Let's be coldly analytical about gold. Since June gold has been flirting with the 390 level. But each time gold climbed above 390, it fell back, acting almost as if it was being manipulated. Last week gold did rally above 390, although the upside action appeared rather tentative (every one point gain seemed like a struggle -- and my thoughts wandered back to the 1979-80 bull market period when gold would jump ten or 15 points in a single day).

I'm including my point & figure chart of gold. Spot gold, second London fix, must hit 396 for an initial upside breakout. IF, IF, if

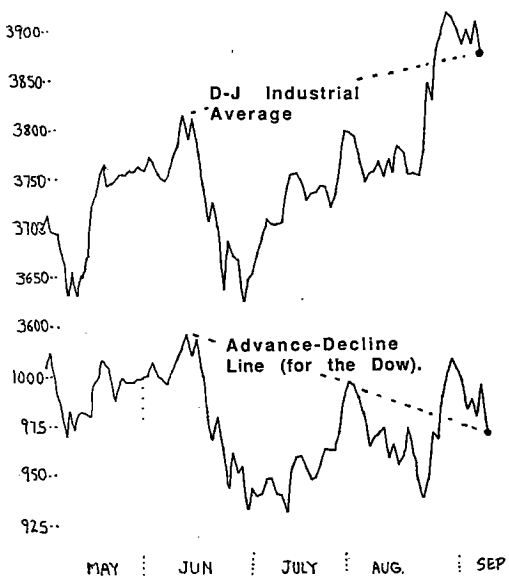


that happens, gold will be in line to attack the 400 level. Once getting above 400, the next target would be the August high of 404. If gold can get there, then the next higher box on the chart, **406,** would represent THE BIG major breakout number. If (again those ifs) spot gold can hit 406, we could then say that gold had completed a massive four-year bottom and was ready to move substantially higher.

Of course there are political implications in any rise by gold above 400. We know that Greenspan has thrown out most or all of his non-performing, lagging inflation barometers. And we know that he is now focused on gold. If gold betters 400, Greenspan will be on the hot seat (if he isn't already) in that he will feel increasing pressure to boost interest rates again (and with elections coming in November, another rate boost would drive the Democrats up the wall).

Conclusion: The gold picture looks more promising now than at any time since the first quarter. But it's strictly up to gold, the metal, now. If the metal climbs, the gold shares will take care of themselves (you do get the feeling that the shares are itching to go higher).

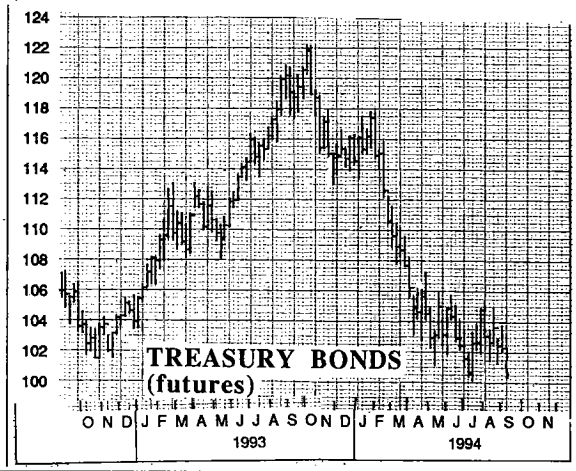
LATE NOTES: As noted in the last Letter, a serious divergence has developed between the Dow and its own advance-decline line (i.e. an A-D line made up exclusively of the 30 Dow Industrial stocks). Since the last Letter this divergence has worsened, as you can see on the chart below (the divergence, in my opinion, created the technical vacuum leading to the big break last Friday, Sept. 9). The PPT report was simply the "excuse."

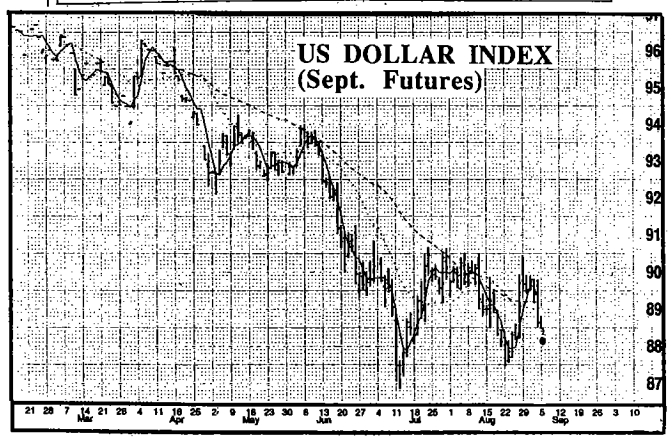


In the meantime, the Transports are diverging increasingly from the Dow. As of now, the Transports are "out of sight" on the downside -- 70 points below their June 16 peak and a full 270 points below their February 2 bull market high. Even if the Dow were to rally to a new bull market high, the Transports would almost surely not confirm (in other words, a new Dow high would simply generate a very bearish primary non-confirmation).

It's hard to believe it, but the market appeared to be "surprised" by last Friday's Producer Price Index figure of **0.6%,** which, by the way, comes out to an annualized wholesale price inflation rate of **7.2%** (highest jump since October, 1990). Actually, the inflationary evidence has been obvious all along as note the following: (1) Car prices, both domestic and foreign, being boosted across the board; (2) Columbia Univ. leading index of inflation up month after month to new 1994 highs; (3) Capacity Utilization (manufacturers) just a fraction below a 14-year high; (4) National Assoc. of Purchasing Managers indices of prices and supplier deliveries at multi-year highs; (5) CRB, DJ and Journal of Commerce commodity indices at or near new highs for the year (I've shown charts of these indices repeatedly). Russell comment: To put it mildly, neither the stock nor the bond markets (or the Fed, for that matter) liked the news. Unfortunately, I expect the inflation news to worsen in the period ahead.

So far, the bear market has played hell with the dollar, utilities, a goodly cross-section of common stocks and almost all money market instruments. The bond chart gives you an idea of what's happened to the top-rated bonds, the US 30-year Treasuries (chart courtesy of *Dunn and Hargitt).* The second chart depicts the collapse of the US Dollar Index, which is now flirting with its low for the year (chart courtesy of *Commodity Trend Service Futures Charts*).





In my opinion, what we're seeing now in the stock market is a titanic struggle between a public, which is still absolutely voracious for stocks -- and the relentless forces of the bear. The surprising figures show that the public is buying funds this year at the monster rate of $11 billion a month vs. last year's huge rate of $10 billion a month. True, the inflow to the funds slowed down a bit around March (with the market's decline), but then it picked up again in July ($9.2 billion) and the August figures are expected to be even higher.

With all this massive buying, it's obvious that someone is giving the public all the stocks it wants -- if they weren't, then the Averages and most stocks would be at new highs. Remember, the advance-decline ratio (which is a proxy for ALL NYSE stocks) topped out on February 2, eight months ago and the A-D ratio (see page 2 chart) is currently far below its February high -- this in the face of all that furious public buying.

MUTUAL FUNDS

By Sara Calian
Staff Reporter of The Wall Street Journal

NEW YORK – Investors accelerated their buying of stock mutual funds this month, adding to a July upswing reported yesterday.